

Issue Brief for Congress

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The Budget for Fiscal Year 2003

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The Budget for Fiscal Year 2003

SUMMARY

On November 19, 2002, Congress cleared the fifth (H.J.Res. 124) in a series of continuing resolutions (CR) on appropriations adopted for fiscal year (FY) 2003. The CRs were necessary because 11 of the 13 regular appropriations bills for the year have not yet cleared Congress. The CRs provide funding (generally at FY2002 levels) for those activities normally covered by the 11 regular appropriations that have not yet been enacted. Two of the regular appropriations bills (Defense and Military Construction) became law in the second half of October.

The Administration's *Mid-Session Review* (July 15, 2002), reflecting the dramatic change in the budget outlook, raised the FY2003 estimated deficit to \$109 billion from the \$80 billion in the Administration's original FY2003 proposals. The Congressional Budget Office's (CBO) August 27, 2002 mid-year report (*The Budget and Economic Outlook: An Update*) estimated the FY2003 deficit at \$145 billion.

The President released his original budget proposals for FY2003 on February 4, 2002, shortly after the release of the CBO annual budget report at the end of January 2002. The baseline estimates for FY2003 in these reports ranged from a small surplus (\$41 billion) from the Administration to a small deficit (\$14 billion) from CBO.

The President's FY2003 budget proposed tax cuts and spending increases to stimulate the economy, rapid increases in defense and homeland security spending, and a selection of other spending increases and decreases in discretionary spending.

The deficits expected in FY2002 and FY2003 would be the first since FY1997. The

weak economy, changes in underlying technical components of the budget estimates, the government's budgetary response to the terrorist attacks in the fall of 2002, and the tax cut adopted in June 2001 contributed to the expected elimination of the previously forecast surpluses.

In early March 2002, CBO released updated baselines and reestimates of the President's policy proposals using CBO's economic and technical assumptions. The estimates produced a baseline surplus of \$6 billion for FY2003. The CBO estimates of the Administration's policy proposals produced a deficit of \$121 billion for FY2003.

The Administration's originally proposed economic stimulus proposal was superseded by stimulus legislation adopted by Congress on March 7, 2002 (The Job Creation and Worker Assistance Act of 2002; P.L. 107-147), that would increase the deficit (from baseline levels) by an estimated \$43 billion in FY2003.

The House Budget Committee adopted its version of the FY2003 budget resolution on March 13, 2003. The House passed the resolution on March 20. The resolution contained a deficit of \$46 billion for the year. Like the President's budget, much of the focus in the resolution was on funding for the war on terrorism and for homeland security.

The Senate Budget Committee reported its version of the FY2003 budget resolution (S.Con.Res. 100) on March 22. Its provisions for defense and homeland security were similar to (but not the same as) those in the House resolution and the President's budget. The Senate did not consider the budget resolution.

MOST RECENT DEVELOPMENTS

Congress adopted the fifth continuing resolution (CR) on appropriations (H.J.Res. 124) providing funding (mostly at FY2002 levels) for federal activities not otherwise funded. The delays in adopting the 13 regular appropriations bills before and since the start of FY2003 have made the series of CRs necessary. Congress began considering the appropriations bills for the new fiscal year in the summer of 2002. As the new fiscal year approached, none of the regular appropriations bills had cleared Congress. Since the beginning of the new fiscal year, Congress has adopted two of the 13 regular appropriations bills, Defense (P.L. 107-248; October 23) and Military Construction (P.L. 107-249; October 23).

Earlier, the Administration's Mid-Session Review (July 15, 2002) lifted the fiscal year (FY) 2003 estimated deficit to \$109 billion. The increase from the President's original proposal reflected lower revenues, higher mandatory and defense spending, and lower nondefense spending than previously expected. CBO's mid-year report, reflecting all the changes in the budget outlook since its previous report (March 2002), put the FY2003 deficit at \$145 billion. Revised estimates should become available from CBO in late January 2003 and from the Administration with the release of its FY2004 budget in early February 2003.

BACKGROUND AND ANALYSIS

Presidents generally submit their budget proposals for the upcoming fiscal year early in each calendar year. The Bush Administration presented its FY2003 budget documents on February 4, 2002. The budget documents contained extensive and detailed budget related information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast. These detailed budget documents are an annual basic reference source for federal budget information in addition to their use as a transmitter of the Administration's policy proposals.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill or bills. During the months of deliberation on budget related legislation, the Administration often modifies its proposals, not only because of interactions with Congress, but because of changing circumstances in the economy and the world.

Budget Totals

The annual budget cycle provides the President and Congress with the opportunity to set policy for the upcoming fiscal year and to partially determine policy in subsequent years. The decisions made for this year can and often do have repercussions for years into the future. Last year's tax cut (the Economic Growth and Tax Relief Reconciliation Act of 2001 – EGTRRA; P.L. 107-16; June 7, 2001) will change federal revenues in each year through 2010, when most of its provisions are scheduled to sunset. Although they are provided each

year in appropriations bills, changes in the level of discretionary spending this year influences future levels of discretionary spending.

Table 1 contains budget estimates and proposals for FY2002 and FY2003 from the CBO, the Administration (OMB), and, as they become available, budget proposals and estimates from Congress. Differences in totals occur because of differing underlying economic, technical, and budget-estimating assumptions and techniques as well as differences in policy proposals. Most *policy* differences between the Administration and various congressional proposals for the upcoming fiscal year are often relatively small in dollars compared to the budget as a whole. These often small changes, reflecting differing policy choices, may have large implications for the shape and content of the budget over extended time periods. As the budget works its way through Congress, budget totals will almost certainly change from the amounts originally proposed.

Table 1. Budget Proposals and Estimates for FY2003 (and FY2002)
(in billions of dollars)

	Receipts	Outlays	Deficit(-)/ Surplus
<i>Actual for FY2001</i>	1,991	1,864	127
<i>CBO Budget Outlook for FY2002 1/31/02</i>	1,983	2,003	-21
<i>President's Budget for FY2002 2/4/02</i>	1,946	2,052	-106
<i>President's Budget for FY2002 baseline 2/4/02</i>	2,011	2,020	-9
<i>CBO revised baseline for FY2002 3/6/02</i>	2,006	2,001	5
<i>CBO estimate of President's Budget for FY2002 3/6/02</i>	1,942	2,033	-90
<i>House budget resolution for FY2002 3/13/02</i>	1,968	2,033	-66
<i>OMB MSR FY2002 7/15/02</i>	1,867	2,032	-165
<i>OMB MSR baseline FY2002 7/15/02</i>	1,868	2,018	-150
<i>CBO Update for FY2002 8/27/02</i>	1,860	2,017	-157
<i>CBO Budget Outlook for FY2003 1/31/02</i>	2,070	2,085	-14
<i>President's Budget for FY2003 2/4/02</i>	2,048	2,128	-80
<i>President's Budget for FY2003 baseline 2/4/02</i>	2,121	2,070	51
<i>CBO revised baseline for FY2003^a 3/6/02</i>	2,086	2,080	6
<i>CBO estimate of President's Budget for FY2003 3/6/02</i>	2,013	2,134	-121
<i>House budget resolution for FY2003 3/20/02</i>	2,077	2,122	-46
<i>Senate Budget Committee for FY2003 3/22/02</i>	2,046	2,139	-92
<i>OMB MSR FY2003 7/15/02</i>	2,029	2,138	-109
<i>OMB MSR baseline FY2003 7/15/02</i>	2,035	2,097	-62
<i>CBO Update 8/27/02</i>	1,962	2,107	-145

^a These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001. MSR – Mid-session review

Budget Proposals and Estimates

Budget proposals and estimates depend on underlying assumptions about the economy, technical components and relationships within the budget estimating models, and assumptions about proposed and assumed current and future government policy. This year, possibly more so than in other recent years, both the expected underlying economic

conditions and the policy choices under consideration appear somewhat less settled among the OMB, CBO, and congressional proposals and estimates than usual.

CBO's initial budget report for FY2003, the *Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002), contained baseline estimates and projections for FY2002 through FY2012.¹ CBO estimated that without any changes from current policy, the FY2003 budget would have \$2,070 billion in revenues, \$2,085 billion in outlays, with a (rounded) deficit of \$14 billion. Over the 10-year forecast period (FY2003 - FY2012) CBO's projections produce a cumulative surplus of \$2,263 billion. Of that amount, \$1,078 billion is generated in the last two years of the projection period when the 2001 tax cuts fully sunset as required by current law.² The 5-year (FY2003 - FY2007) cumulative surplus, reflecting the deficits and relatively small surpluses expected over this period, is \$437 billion.

President Bush's FY2003 budget proposed receipts of \$2,048 billion, outlays of \$2,128 billion, with a resulting deficit of \$80 billion. The Administration's proposals produced a 10-year total cumulative surplus of \$1.0 trillion. Its 5-year cumulative surplus was \$157 billion. (The President's budget provided most data for the 5-year period, FY2003 through FY2007; the budget provided very little data for either the individual years beyond FY2007 or cumulatively for the 10-year period, FY2003 through FY2012.)

The Administration's current services baseline estimates (the Administration's estimate of what the budget numbers would be without policy changes) show FY2003 receipts of \$2,121 billion, outlays of \$2,080 billion, with a resulting surplus of \$41 billion.³ The differences between these baseline numbers and the proposed amounts measure the dollar effect on the budget, in FY2003, of the Administration's proposals. The proposals would increase outlays by \$58 billion, reduce receipts by \$73 billion, and move the current services baseline from a \$41 billion surplus to an \$80 billion deficit. Over the FY2003 through FY2007 period, the time period covered by the Administration's baseline estimates, the baseline estimates show a cumulative surplus of \$668 billion, meaning that the Administration's proposals reduce the cumulative baseline surplus by \$511 billion over the 5 years.

CBO's estimate of the Administration's proposals (*An Analysis of the President's Budgetary Proposals for Fiscal Year 2003*, March 2002), using CBO's economic and

¹ Baseline estimates provide a foundation from which to measure proposed policy changes. They extrapolate current policies into the future based on expectations of the future economy and other factors that affect the budget formulated under fairly explicit rules. They are not meant to predict future budget outcomes.

² CBO estimated that extending the expiring provisions immediately would reduce cumulative revenues over the 10-year period by \$735 billion. The implication is that the cumulative surplus over the 10-years would be reduced by at least as much and probably by more if higher interest costs are included.

³ The Administration also produced a variant of the standard baseline. The alternative assumed that the increased (mostly) emergency spending in FY2002 flowing from the September 11, 2001 terrorist attacks was a one-time event and would not be repeated. Making this assumption increases the baseline surplus to \$51 billion in FY2003. The Administration measured its policy against this altered baseline. This report uses the standard baseline.

technical assumptions, raises the estimated deficit for FY2003 (from the Administration's proposed \$80 billion) to \$121 billion. CBO's reestimates reduce revenues by \$35 billion and increase outlays by \$6 billion from the Administration's numbers, producing the \$41 billion difference in the deficit estimate.

The CBO report also included updated CBO's baseline estimates that made relatively small changes in the estimates for FY2003. The updated numbers show a surplus of \$6 billion for FY2003, instead of the \$14 billion deficit estimated in January. Most of the change occurred because of higher expected revenues (\$15 billion) and slightly smaller expected outlays (\$5 billion).⁴ Expectations of better short-term economic conditions produced most of the improvement in the budget outlook.⁵ Over the 10-year CBO forecast period, the changes increased the cumulative surplus from \$2,263 billion to \$2,380 billion, a 5% increase over the January cumulative surplus estimate. The updated baseline estimates increased the cumulative 5-year (FY2003-FY2007) surplus from \$437 billion to \$489 billion, a 12% increase. (Unofficial early summer 2002 budget estimates, based on budget data available for FY2002, indicated a further deterioration in the budget outlook, implying larger than previously expected deficits for the year.)

The House passed budget resolution (H.Con.Res. 353; March 20, 2002) followed, in general, the policy lead of the President's budget. Using the same underlying budget assumptions as the Administration, the resolution had revenues of \$2,077 billion, outlays of \$2,123 billion, with a deficit of \$46 billion. The resolution, like the President's budget, contained estimates and projections for 5 years, through FY2007. The resolution expected the government to return to a small surplus in FY2004. Over the 5-year period, the resolution produced a cumulative surplus of \$231 billion.

The Senate Budget Committee reported its version of the FY2003 budget resolution (S.Con.Res. 100; S.Rept. 107-141) on March 22. Using CBO's underlying assumptions (rather than the Administration's), the Senate Budget Committee resolution provided similar amounts of funding in FY2003 for defense and homeland security as the House-passed resolution but differed in other areas. Total revenues were \$2,046 billion, total outlays were \$2,139 billion, and the resolution had a deficit of \$92 billion (most of the difference between the House and Senate Budget Committees' total for FY2003 was from differences in the underlying assumptions used rather than major policy differences in FY2003).

The Mid-Session Review (MSR) from the Administration forecast a fairly rapid recovery for both the economy and federal revenues. Under the assumptions and policy choices in the MSR, the deficit would decline from FY2002 to FY2003 (from \$165 billion to \$109 billion) and return to surplus in FY2005. Under baseline assumptions, the budget would return to surplus in FY2004. CBO's August *Update* had access to more recent and revised budget and economic data than did OMB. CBO's baseline estimates put the FY2003

⁴ CBO estimates that incorporating the effects of the economic stimulus package signed into law (P.L. 107-147) on March 9, 2002, (and not included in CBO's revised baseline) produces a \$40 billion deficit in FY2003.

⁵ The \$20 billion improvement in the budget balance represents only 1% of total receipts or outlays for the year. Relatively small changes in the underlying factors supporting the budget estimates can easily change receipts or outlays by larger amounts than this without any change in policy.

deficit at \$145 billion, somewhat smaller than its FY2002 deficit estimate of \$157 billion. It expects the budget to return to surplus in FY2006, assuming no change from existing policies.

Part of the annual budget debate's intensity results from the awareness that the decisions made for this year affect, in some cases substantially, the funding levels or policy choices available to Congress in future years.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial uncertainty and variation makes budget estimates and projections susceptible to fairly rapid and dramatic changes. Nonetheless, budget estimates can help differentiate alternative budget proposals and the effects and approximate magnitudes of various policy proposals even if the estimates do not match the actual outcomes.

The uncertainty of budget estimates was visibly apparent during the last year. The estimates for the just ended fiscal year, 2002, produced early in 2001, projected baseline surpluses of between \$283 billion (OMB) and \$313 billion (CBO). The Administration's FY2002 proposals (February 2001), included a combination of tax cuts and spending increases that produced a surplus of an estimated \$231 billion. The budget estimates released in the summer of 2002 (the OMB MSR and the CBO Update) for FY2002 show baseline *deficits* of \$150 billion to \$157 billion, while OMB's policy estimate for FY2002 has become a deficit of \$165 billion. The large baseline surpluses expected early last year (less than 18 months ago) evaporated in a weak economy, the June 2001 tax cut, the spending increases in response to the terrorist attacks of September 2001, and substantial changes in the technical components and relationships underlying the budget estimates.

The unavoidable inaccuracy of budget projections is also obvious over longer periods of time. As CBO stated in its January 2002 budget report,

Uncertainty compounds as the projection horizon lengthens. Even small annual differences in the many key factors that influence the budget projections – factors such as inflation, increases in productivity, economic growth, the distribution of income, and growth rates from Medicare and Medicaid spending – can add to substantial differences in the budget outcome 10 years from now.⁶

Budget projections are dependent on underlying assumptions about the direction of the economy, future government policy, and the technical assumptions of the budget models, and how these interact. Any deviation from expected underlying assumptions, such as faster or slower economic growth, higher or lower inflation, changes in assumed spending and tax policy or alterations in the fundamental underlying relationships between the budget and economic variables (and the underlying technical assumptions) can have substantial effects on the budget projections.

⁶ CBO, *The Budget and Economic Outlook: Fiscal Years 2003-2012*, Jan. 2002, pp. 5-6.

Budget Action

Congress considered and passed an economic stimulus bill in early March 2002. The legislation, the Job Creation and Worker Assistance Act of 2002 (P.L. 107-147; March 9, 2002) increased FY2003's expected deficit by an estimated \$43 billion (plus another \$3 billion in higher interest costs). The legislation, passed as an economic stimulus package, extends unemployment benefits, reduces selected business taxes, extends selected expiring tax provisions, and makes miscellaneous technical corrections to the tax code.

The House Budget Committee approved its version of the annual concurrent resolution on the budget for FY2003 (H.Con.Res. 353) on March 13, 2001. The resolution used a slightly modified version of OMB's economic and technical assumptions rather than CBO's. Like the President's budget this year, the resolution extended its projections 5 years into the future rather than the 10 years that had been used in the last few years.

The resolution had a \$46 billion deficit for FY2003 that closely matches the estimated cost of the economic stimulus bill adopted days earlier. It included almost \$28 billion in unspecified tax cuts over 5 years (with upper limits for the size of the cuts for each year), a \$46 billion year-over-year increase in budget authority for defense, close to a doubling of funding for homeland security between FY2002 and FY2003, and very small increases (overall) for remaining discretionary spending. The resolution was adopted in committee on a party-line vote. The House adopted the resolution on March 20.

The Senate Budget Committee adopted its version of the budget resolution (S.Con.Res. 100) on March 22. The Committee's resolution differed substantially in policy choices, in areas other than defense and homeland security, from the one adopted by the House. Although many of the differences are relatively small in FY2003, they become more significant over the years covered by the two resolutions. The Senate Budget Committee's resolution extends through FY2012. The Senate has not considered the Committee's resolution.

To avoid delaying its consideration of appropriations, the House adopted a deeming resolution (H.Res. 428) on May 22, 2002 (see CRS Report RL31443, *The "Deeming Resolution": A Budget Enforcement Tool*, by Robert Keith). This set spending levels to be followed by the Appropriations Committee. The Senate has yet to adopt a budget resolution for the year (or a deeming resolution as in the House). In spite of the lack of guidance from a completed budget resolution, the House adopted five and the Senate passed three of the 13 regular appropriations bills for FY2003 as the new fiscal year approached, but none of the regular appropriations bills have cleared Congress.

To avoid a funding crisis, Congress cleared a continuing resolution (CR) on appropriations (H.J.Res. 111; September 26, 2002) that became law (P.L. 107-229) on September 30. The CR provided funding mostly at FY2002 spending levels for federal activities not otherwise funded, through October 4, 2002. A second CR (H.J.Res. 112), extending funding through October 11, cleared Congress on October 3, and was signed by the President (P.L. 107-235) on October 4. Congress adopted a third CR (P.L. 107-240; H.J.Res. 122) on October 10, providing funding through October 9. Funding was extended through November 22, 2002, by the fourth CR (H.J.Res. 123) that Congress cleared for the President on October 16. The bill was signed into law (P.L. 107-244) on October 18, 2002.

Congress cleared two of the 13 regular appropriations bills, Military Construction (H.R. 5011) on October 10, 2002 and Defense (H.R. 5010) on October 16, 2002. Both became law on October 23, 2002 with the President's signature (Defense, P.L. 107-248 and Military Construction, P.L. 107-249). Congress cleared a fifth CR, (H.J.Res. 124) funding, through January 11, 2003, those government activities covered by the 11 regular appropriations bills still pending.

Outlays

The President's budget proposed total outlays of \$2.138 trillion for FY2003, \$76 billion over the Administration's revised FY2002 level.⁷ The year-to-year change is composed of proposed policy changes (approximately \$26 billion in the President's proposal) and relatively automatic growth in outlays in mandatory programs resulting from inflation adjustments and demand growth. CBO's estimates of the President's budget put the year-to-year increase in outlays at \$101 billion. Of that amount, CBO estimates that \$22 billion resulted from proposed policy changes with the rest coming from inflation adjustment and demand growth. Outlays in the Administration's baseline estimates (excluding the effects of policy change) increase by \$50 billion from FY2002 to FY2003.

Table 2. Outlays for FY2001-2007

(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	\$1,864 ^a	\$2,003	\$2,085	\$2,152	\$2,238	\$2,319	\$2,402
President's Budget 2/4/02		2,052	2,128	2,189	2,277	2,369	2,468
OMB Baseline 2/4/02		2,020	2,080	2,142	2,218	2,289	2,366
CBO Revised Baseline ^b 3/6/02		2,001	2,080	2,148	2,231	2,312	2,394
CBO Estimate of Pres.'s Budget 3/6/02		2,033	2,134	2,201	2,291	2,394	2,493
House Budget Resolution 3/13/02		2,033	2,123	2,192	2,289	2,383	2,479
SBC Budget Resolution 3/22/02		—	2,139	2,207	2,313	2,403	2,496
OMB MSR 7/15/02		2,032	2,138	2,217	2,298	2,390	2,483
OMB MSR baseline 7/15/02		2,018	2,097	2,163	2,232	2,301	2,376
CBO Update 8/27/02		2,017	2,107	2,195	2,283	2,366	2,461

SBC = Senate Budget Committee

a. Actual outlays for FY2001.

b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001

The Administration's proposals would raise FY2003 outlays by \$58 billion over the FY2003 baseline estimate, measuring the effect of its policy proposals on outlays for the year. The proposals included an increase in defense spending of \$21 billion, farm support legislation (\$7 billion) and the "bipartisan economic security plan" (\$8 billion). The remaining proposed policy changes were scattered throughout other categories of spending.

⁷ The Administration proposed a \$32 billion increase in FY2002 outlays above baseline levels, most of which was for its proposed "bipartisan economic security plan." The FY2002 estimate also did not include any outlays that might flow from the adoption of the Administration's \$27 billion (in budget authority) supplemental spending request sent to Congress on March 21, 2002.

Over the 5 years covered in detail in the President's budget (FY2003-FY2007), total outlays would rise from \$2,052 billion in FY2002 to \$2,128 billion in FY2003 to \$2,468 billion in FY2007. The average annual rate of growth in outlays over the FY2003 through FY2007 period is 3.8% a year, almost the exact same rate of growth as over the previous 5-year period (FY1997-FY2002). Over the 5 years, the Administration proposes cumulative outlays of \$11,431 billion. (Over 10 years, FY2003-FY2012, shown in a few tables, the Administration proposes cumulative outlays of \$25,478 billion.)

CBO's estimates of the Administration's proposals (March 2002) raised estimated FY2003 total outlays by \$6 billion. CBO's 5-year cumulative estimate of the President's policy proposals differs by only \$81 billion, of which \$44 billion results from higher net interest payments.⁸ Over the longer 10-year period, CBO's estimates increase cumulative outlays above the President's budget by slightly more than a 1% increase or \$296 billion. Most of the annual differences between the OMB and CBO estimates of the President's outlay proposals are also relatively small compared to total outlays in those years.

The outlays proposed in the House passed budget resolution (H.Con.Res. 353) are similar to the ones contained in the President's budget. The House Budget Committee, in producing the resolution, used the Administration's underlying assumptions and followed many of the policy proposals, ensuring a close similarity between the two proposals. The Committee report (H.Rept. 107-376) compares the budget resolution to the President's proposals (see pages 74-75 in the report). Total outlays in the budget resolution are \$5 billion smaller than the President's proposed total outlays for FY2003, but larger in each subsequent year. Over the 5 years covered by the two proposals, cumulative outlays in the House budget resolution are \$35 billion larger than the President's proposed cumulative outlays, with both increases and decreases to components of the budget – compared to the President's proposals – scattered throughout the budget.

The Senate Budget Committee's budget resolution used CBO's underlying assumptions, in contrast to the House's use of OMB assumptions. This difference by itself would assure somewhat different numbers in the two budget resolutions even if they contained the same policy assumptions (which they do not). The Senate Budget Committee's budget resolution follows the policies of the House and Administration outlay levels for defense and homeland security in FY2003 and FY2004, and in general the spending levels for mandatory programs, although the proposed policies for mandatory programs differ. Spending for non-defense, non-homeland security discretionary spending in the Senate Budget Committee budget resolution differs from the allocations found in the House passed budget resolution and the amounts contained in the President's budget. Many of these differences are relatively small in FY2003 but grow over time. The Senate has not considered the Committee's adopted resolution.

The House passed and the Senate Budget Committee reported budget resolutions, as well as the President's budget, would all provide a large boost in defense outlays from FY2002 to FY2003 of approximately 9%, using each proposal's own numbers. Between

⁸ CBO's larger deficits and smaller surpluses in its estimates of the President's budget policies slow the reduction in federal debt held by the public compared to the level in the Administration's budget. The larger debt held by the public in the CBO estimate raises the amount of net interest that the government must pay.

FY2003 and FY2007 (the last year shown in the House and presidential budget proposals) the President's budget and the House budget resolution show defense outlays growing by almost 4% annually. The Senate Budget Committee passed budget resolution has defense outlays growing annually by 2% during these years.

Non-defense discretionary spending also gets a larger boost between FY2002 and FY2003 than in subsequent years in the three proposals. The President's budget shows these outlays growing by 4.5%, the House budget resolution by 5.0%, and the Senate Budget Committee budget resolution by 8.2% between FY2002 and FY2003. The average rate of growth for non-defense discretionary spending in subsequent years in all three proposals is less than 2%, a rate that will not maintain spending for these programs against inflation or population growth. (By comparison, the CBO March baseline estimates of non-defense discretionary spending shows them growing by 2.7% annually in subsequent years, a rate designed to adjust spending for inflation but not population growth.)

The Administration's MSR raised estimated total outlay by \$10 billion over the original proposal in February 2002. Two-thirds of the increase results from adopted or proposed policy changes and the remaining third is attributed to economic and technical estimating changes. Over the 5-year period (FY2003-FY2007) covered in the MSR, cumulative outlays are 0.8% higher than in the February budget proposals. Compared to the original February proposals, discretionary spending shrinks (by 1.2%) while mandatory spending increases (by 1.6%) and net interest increases (by 3.4%) over the 5 years.

CBO's *Update* (August 27, 2002) also contained changed outlay estimates for FY2003 (and subsequent years) compared to earlier estimates. Since CBO's March 2002 estimates, estimated outlays have risen by \$28 billion. Legislative changes increased estimated outlays by \$40 billion, technical changes raised estimated outlays by \$11 billion, while changes in the economic outlook *reduced* estimated outlays by \$23 billion. The changes raised estimated outlays from \$2,080 billion in March 2002 to \$2,107 billion in August 2002.

Receipts

The President's FY2003 budget (February 2002) proposed \$73 billion in tax cuts for FY2003 (and \$65 billion tax cut in FY2002) leading to a \$102 billion increase in receipts from FY2002 to FY2003. Without the proposals, receipts would increase by \$110 billion between the two years. CBO's March 2002 estimates of the President's proposals put the year-to-year increase at \$71 billion. The Administration's budget proposed \$2,048 billion in receipts for FY2003; CBO estimated that the President's proposals under CBO's economic and technical assumptions would produce receipts of \$2,013 billion in FY2003.

The President's budget also proposed making much of the tax cut adopted last year, the EGTRRA, permanent, along with extending a number of tax provisions scheduled to expire during the next five to 10 years. Under current law, most provisions of last year's tax cut would expire at the end of calendar year 2010. Making the tax cuts permanent would have little effect in FY2003, but would reduce receipts substantially in FY2011 and 2012 from baseline levels.

The Administration estimates that its EGTRRA proposals would reduce revenues by \$7 billion between FY2003 and FY2007 and by \$343 billion between FY2003 and FY2012. CBO and the Joint Committee on Taxation estimate that extending the provisions expiring in 2010 would reduce revenue by \$9 billion between FY2003 and FY2007 and by \$374 billion between FY2003 and FY2012 (most of the revenue reduction, \$356 billion, occurs in the last two years).⁹ The Administration also proposed extending the research and experimentation (R&E) tax credit, which would reduce revenues by an estimated \$14 billion to \$15 billion over the FY2003 to FY2007 period and by \$51 billion to \$54 billion over the FY2003 to FY2012 period. CBO and the Joint Committee on Taxation estimate that extending all the other expiring tax provisions expiring through FY2012 (including the R&E tax credit) would reduce revenues by an estimated \$78 billion between FY2003 and FY2007 and by \$205 billion between FY2003 and FY2012.¹⁰

Table 3. Receipts for FY2001-2007

(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	\$1,991 ^a	\$1,983	\$2,070	\$2,206	\$2,342	\$2,447	\$2,568
President's Budget for FY2003 2/4/02		1,946	2,048	2,175	2,338	2,455	2,571
OMB Baseline 2/4/02		2,011	2,121	2,234	2,366	2,461	2,581
CBO Revised Baseline ^b 3/6/02		2,006	2,086	2,209	2,342	2,448	2,569
CBO Estimate of Pres.'s Budget 3/6/02		1,942	2,013	2,150	2,314	2,442	2,560
House Budget Resolution 3/13/02		1,968	2,077	2,200	2,356	2,472	2,593
SBC Budget Resolution 3/22/02		—	2,046	2,180	2,338	2,464	2,586
OMB MSR 7/15/02		1,867	2,029	2,169	2,351	2,451	2,567
OMB MSR baseline 7/15/02		1,863	2,035	2,180	2,369	2,475	2,595
CBO Update 8/27/02		1,860	1,962	2,083	2,244	2,381	2,513

SBC = Senate Budget Committee.

a. Actual receipts for FY2001.

b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001

The House passed budget resolution would increase receipts by \$110 billion between the two years, with both FY2002 and FY2003 showing higher revenues than the President's budget. The House resolution reflected the revenue effects of the adoption of the Job Creation and Worker Assistance Act of 2002 (JCWAA), which reduces receipts by \$43 billion in FY2002 and \$39 billion in FY2003 (as estimated by the Joint Committee on Taxation). The resolution accommodates \$28 billion in unspecified additional tax reductions through FY2007. It also accepts, although with relatively little effect because of the assumed offsets in the years covered by the resolution, the Administration's proposals to remove EGTRRA's sunset provisions.

⁹ Making permanent the provisions of the 2001 tax cut expiring before 2010 produce estimated revenue reductions of \$36 billion between FY2002 and FY2007 and \$194 billion between FY2003 and FY2012.

¹⁰ The reduced revenues in these various estimates increase deficits or reduce surpluses raising the federal debt above the level under current law. This increases the government's net interest payments over the period.

The Senate Budget Committee's reported budget resolution shows receipts increasing by \$83 billion between FY2002 to FY2003. Like the House resolution, the Senate Budget Committee resolution reflects the revenue effects of the adoption of the JCWAA. The Senate Budget Committee resolution assumes no changes to the existing sunset provisions of EGTRRA. The resolution further assumes that any proposed revenue reductions be offset to avoid a net reduction in receipts.

The Administration's MSR reflected the deterioration in revenue estimates resulting from changes since the February proposals in the underlying policy, economic, and technical assumptions. Receipts are below the February budget numbers in each year except for FY2005. For FY2003, the Administration estimated that changes in the underlying economic and technical assumptions reduced receipts by \$51 billion below the February level. Enacted legislation and changed proposals raised receipts by \$31 billion (compared to February proposals – the Administration's proposed economic stimulus proposal contained larger tax cuts than the legislation that became law, raising estimated revenues). The changes dropped receipts for FY2003 by almost \$20 billion from earlier in the year. (Revised FY2002 estimated receipts in the MSR, reflecting the substantial fall in receipts, dropped FY2002 receipts by almost \$91 billion from the February estimate). The MSR includes estimates that cumulative five-year (FY2003-FY2007) receipts will fall \$21 billion below the February proposed level.

CBO's August 2002 *Update* had newer budget data and revised economic data from which to produce its revised estimates compared to the OMB's MSR. The revised CBO baseline revenue estimates for FY2003 are \$124 billion lower than CBO's March baseline revenue estimates (dropping from \$2,086 billion to \$1,962 billion). Over the 5-year period, FY2003 through FY2007, cumulative revenues have fallen by \$470 billion between the March and August CBO baseline revenue estimates. CBO attributes about half of the FY2003 revenue decline to change in the estimates technical assumptions. One-third of the change in revenues CBO attributed to legislative changes, with the remaining portion of the revenue change attributed to differences in the economic assumptions used in the March and August reports. Over the 5-year period, CBO estimates that the technical changes produce 65% of the change, differences in economic assumptions generates 25% of the change, and the remainder comes from legislative change.

Surpluses Or Deficits

Surpluses or deficits are the residuals left after Congress and the President determine the general level of spending and receipts. Reducing the deficit and eventually reaching a balanced budget or generating and keeping a surplus (the government had its first surplus in 30 years in FY1998) had been a major focus of the budget debate for over a decade. The original baseline projections from both OMB and CBO (in early 2002 for FY2003 through FY2007 or FY2012) showed modest deficits in the early years and small, but growing, surpluses in the years through FY2007 or FY2012.

In general, surpluses reduce federal debt held by the public (the government is able to retire some of the debt it created when it had deficits). An expected surplus can also be used to finance spending increases or tax reductions, either of which will reduce (or eliminate) the previously forecast surplus. The Treasury in its normal debt management operations will use

the surplus to reduce federal debt held by the public. The Treasury took an active role in retiring debt held by the public over the 4 years of surplus (FY1998-FY2001) by purchasing securities on the market and retiring some callable federal bonds. (The Treasury also could retain the cash generated by a surplus and build up government cash balances, but this would make little sense for the government or the economy and seems unlikely.)

The President's proposals and the House passed budget resolution for FY2003 would use the then forecast baseline surpluses to increase spending and cut taxes. The small remaining surpluses in future years in these proposals would be used to reduce the debt held by the public. The budget resolution passed by the Senate Budget Committee would have used the surplus for some spending increases and the rest for reducing the debt held by the public. None of the proposals reserved the entire Social Security surplus for debt reduction (a goal striven for in the budget proposals last year).

Table 4. Deficits(-)/Surpluses for FY2001-FY2007

(in billions of dollars)

	FY2001	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007
CBO Outlook 1/31/02	\$127 ^a	-\$21	-\$14	\$54	\$103	\$128	\$166
President's Budget for FY2003 2/4/02		-106	-80	-14	61	86	104
OMB Baseline 2/4/02		-9	41	92	148	172	215
CBO Revised Baseline ^b 3/6/02		5	6	61	111	135	175
CBO Estimate of Pres.'s Budget 3/6/02		-90	-121	-51	24	48	68
House Budget Resolution 3/13/02		-66	-46	8	67	89	113
SBC Budget Resolution 3/22/02		—	-92	-27	26	60	90
OMB MSR 7/15/02		-165	-109	-48	53	60	80
OMB MSR baseline 7/15/02		-150	-62	17	137	174	219
CBO Update 8/27/02		-157	-145	-111	-39	15	52

SBC = Senate Budget Committee.

a. Actual surplus for FY2001.

b. These numbers exclude the effects of the economic stimulus law (P.L. 107-147) enacted on March 9, 2001
MSR – Mid-Session Review

The budget outlook-changing events of 2001 (the terrorist attacks, the weakened economy, and policy changes), as reflected in revised budget forecasts in 2002, ended the 2001 forecasts of substantial and growing surpluses throughout the forecast period. The early 2002 budget estimates and forecasts expected a small (\$14 billion – CBO) baseline deficit or a small (\$41 billion – OMB) surplus in FY2003. The President's proposals turned the baseline surplus into an \$80 billion deficit. CBO later (March 2002) estimated that the President's proposals would produce a \$121 billion deficit in FY2003. The MSR raised the Administration's estimate of the deficit to \$109 billion in FY2003 (with a baseline deficit of \$62 billion for the year). CBO's *Update* estimates that FY2003 will have a baseline deficit of \$145 billion. With Congress working to complete FY2003 budget action along with the uncertain economic outlook, the budget balance for the year remains very uncertain.

The Budget and the Economy

The budget and the economy affect each other. The relationship is an unequal one, with the economy influencing the budget with every economic twinge while even substantial policy changes may disappear in the overall economy with little notice or consequence.

Until the release of the revised, more negative budget estimates in August 2001, the earlier 10-year positive budget forecasts in 2001 had been buoyed by the expectation of a continuation of favorable economic conditions into future years. The previous (until the August 2001 estimates) economic outlook supported the expectations of the continuation of the overall improvement in the budget situation since the early 1990s. Much of that budget improvement came from strong and sustained economic growth along with the congressional and presidential efforts to balance the budget. If those favorable economic conditions should falter (as they did last year), so would a major underpinning of the good budget fortunes of the previous years. What good economic conditions give, bad economic conditions can take away. The unexpectedly lengthy economic sluggishness, the start of a recession in March 2001, (along with the budgetary and economic responses to the September 2001 terrorist attacks), raised outlays, reduced receipts, and substantially changed the budget balance expectations and magnitude from what was forecast a year ago.

CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002) in its chapter on *The Uncertainties of Budget Projections*, indicated how significantly the budget outlook can be altered by changing the underlying economic assumptions. The chapter contains optimistic and pessimistic alternative scenarios, along with its baseline projection (see Table 5). The optimistic scenario assumes that the positive underlying economic and other factors of the last few years would continue into the future. The pessimistic scenario assumes that the favorable conditions of the last few years have been an aberration and that the economy and other underlying factors revert to the conditions that prevailed previously.

**Table 5. CBO's Alternative Scenarios,
Cumulative Surpluses/Deficits(-); FY2003-2007 and FY2003-2012**
(in billions of dollars)

	FY2003-FY2007	FY2003-FY2012
CBO Optimistic Scenario Total Surplus 1/31/02	\$1,448	\$5,926
CBO Baseline 1/31/02	416	2,243
CBO Pessimistic Scenario Total Surplus 1/31/02	-732	-1,979

The result of CBO's exercise is a wide range of possible budget outcomes. Under the optimistic scenario, the surpluses accumulate over the 10-year period (FY2003-2012) to almost \$6 trillion. Under the pessimistic scenario, a string of deficits appear, accumulating to almost \$2 trillion over the same 10 years. The two scenarios' cumulative budget balances diverge over the 10 years by \$8 trillion. Even for FY2003, the differences between the two scenarios is relatively wide, ranging from a surplus of \$61 billion in the optimistic scenario to a deficit of \$101 billion in the pessimistic scenario. As CBO's *Update* indicated, the January 2002 pessimistic scenario was too optimistic, at least for FY2003. Over the 5- and

10-year periods, the January pessimistic scenario produces larger deficits than does the August 2002 CBO *Update*.

In addition to the alternative scenarios, CBO provides estimates of the effects on the budget of changes in selected economic assumptions underlying the budget estimates and projections (see appendix A in the *Budget and Economic Outlook: Fiscal Years 2003-2012*, January 2002). OMB provides similar measures in the President's budget (see chapter 1 in the Analytical Perspectives volume of the *Budget of the United States Government for FY2003*). Both CBO and OMB estimate that a sustained reduction of 1% in the real rate of GDP growth beginning in early 2002, would reduce the surplus by approximately \$30 billion in FY2003 and by growing amounts in subsequent years. Estimates are provided in both reports for the effects on the budget of selected economic variables – real economic growth, inflation, unemployment, and interest rates. Larger changes in the underlying economic variables would produce larger changes in the budget numbers.

LEGISLATION

H.Con.Res. 353

The Concurrent Resolution on the Budget for Fiscal Year 2003. Adopted by the House Budget Committee (H.Rept. 107-376) on March 15, 2001, on a party line vote after rejecting numerous amendments. It follows most of the proposals of the Administration. It was adopted by the House on March 20.

S.Con.Res. 100

The Concurrent Resolution on the Budget for Fiscal Year 2003. Adopted by the Senate Budget Committee (H.Rept. 107-141) on March 22, 2001, on a party line vote. Its proposals for defense and homeland security were similar to those of the Administration, but differed in many other areas of the budget.

CONGRESSIONAL HEARINGS, REPORTS, AND DOCUMENTS

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— Senate. Committee on the Budget. *Concurrent Resolution on the Budget – FY2003; Report to Accompany S.Con.Res. 100*. April 11, 2002 Washington, U.S. G.P.O., 2002. (107th Congress, 2nd session. S.Rept. 107-141).

FOR ADDITIONAL READING

Also see the CRS Electronic Briefing Book on Taxation at:
[<http://www.congress.gov/brbk/html/ebt1r1.shtml>]

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CRS Report RL30854. *Uncertainty in Budget Projections*, by Philip Winters.